

Opening Remarks
House Subcommittee on Government Management, Finance, and Accountability of the
Committee on Government Reform

Hearing on the Fiscal Year 2004 Financial Statement Audit
and Corrective Actions at the Department of Justice

Mr. Chairman and Members of the Subcommittee:

I am very pleased to have the opportunity to appear before you today to discuss the FY 2004 financial statement audit results at the Department of Justice. As the Department's Chief Financial Officer, I am fully committed to ensuring our financial operations, systems, controls, and reports are of the highest reliability, and that they meet or exceed federal accounting standards. Excellence in financial management is a key element of the Department's performance plan, and the Attorney General and I are committed to restoring the Department's unqualified audit opinion on our financial statements, reducing the number of significant control weaknesses, and improving the ongoing quality of financial data. It is a goal that is shared across the Department, not just by our financial managers, but by senior leadership throughout the Department's components.

The Department has made significant strides in improving its financial operations in the past four years, but, as last year's results demonstrate, we still face major challenges. Despite notable improvements in terms of correcting financial weaknesses, certain areas of our operations still do not have the needed internal controls or fundamental reliability that enable us to routinely produce accurate and timely financial reports. We are still at risk where our operations

remain dependent on manual business practices and outdated systems while performing ten separate financial audits across seven distinctly different core accounting systems. We are targeting our corrective actions in these areas. We value the insights we gain from the Inspector General and reports of the independent auditors, and we are committed to meeting the increased financial management reporting and internal control requirements demanded by new federal guidance.

This afternoon, I would like to discuss our efforts in three areas: first, the weaknesses identified in last year's audits; second, our efforts to correct those weaknesses and restore the Department's unqualified financial opinion; and third, our ongoing efforts to improve the financial systems infrastructure of the Department.

The Fiscal Year 2004 Financial Audits

When FY 2004 began, the Department, like other executive branch federal agencies, was faced with the challenge of preparing its financial statements and completing the audit of the statements by November 15th. This accelerated due date, set by the Office of Management and Budget (OMB), reduced the timeframe for preparation and audit by nearly ten weeks from the previous Fiscal Year. While the Department was able to meet the accelerated submission date, we were unable to obtain an unqualified opinion on our financial statements as we had

done in previous years. Last year, because of difficulties in accurately reporting certain grant related balances and internal control weaknesses in grant related systems, the Office of Justice Programs (OJP) received a disclaimed audit opinion from the independent auditors. The balances at OJP are so large – so “material” to use the accountants’ and auditors’ term - that the Department-wide consolidated financial statements were disclaimed on the same basis even though eight of ten individual audits in the Department were unqualified. OJP Balances represent over 13% of the Department’s net cost. The problems had a perverse psychological affect on the financial statements issued in prior years, and the auditors from FY 2003 ultimately rescinded the unqualified opinions they had previously issued to OJP and the Department. Beyond the OJP issue, a second, smaller component, Alcohol, Tobacco, Firearms, and Explosives (ATF), received a qualified opinion due to weaknesses in its payables reporting.

Before outlining our corrective actions, I think it is important to mention that despite the disclaimed opinion on last year’s consolidated financial statements, individual audit reports showed that many components of the Department made solid improvements in their reporting and operations. The Department’s statements are based on ten component-level audits, and eight of our ten components received unqualified opinions from the auditors. I was pleased to see that the Bureau of Prisons (BOP), the Drug Enforcement Administration (DEA), the Federal Prison Industries, the Offices, Boards, and Divisions (OBD’s), the Working Capital Fund (WCF), and the Assets Forfeiture

Fund all earned unqualified opinions and had no material weaknesses reported in their internal controls. The Federal Bureau of Investigation (FBI) and the United States Marshals Service (USMS) earned unqualified opinions but still had material weaknesses reported in their accounting procedures, property, or information systems. Overall, three of our components eliminated material weaknesses from prior year audits. Additionally, the majority of the components demonstrated they have well-developed reporting structures and controls, and that they are well positioned to meet the FY 2005 quarterly statement due dates and the annual November 15th due date.

Nonetheless, despite the noticeable progress I've mentioned, FY 2004 was a year that fell far short of our goals. At the OJP, the audit firm closely questioned the reliability and accuracy of the accounting practices used in prior years, particularly with regard to the estimation techniques for determining amounts expended by grantees and the balance of amounts advanced to grantees. Ultimately, the auditors could not complete testing at OJP to opine on the accuracy of OJP's financial data because OJP's information technology (IT) system controls were found to be unreliable. Once the auditors determined they could not rely on system generated accounting data, OJP was unable to present grantee expense data that could be sufficiently tested and the financial statements were disclaimed. Overall, the auditors determined that OJP's grant accrual and advance accounting practices were inadequate, accounting for intragovernmental transactions needed improvement , monitoring of grantee expense data was weak,

and significant weakness existed in OJP's IT general and application controls. While we did not see evidence that OJP's overall grant programs were compromised due to the reporting and system problems, it is clear that we must correct the OJP accounting and systems weaknesses so that we provide our grants managers and grantees with reliable and timely information.

In addition to the accounting and systems weaknesses at OJP, auditors reported two material weaknesses at the FBI, two at the USMS, and one at ATF. At the FBI, auditors determined that the management of obligations needs improvement, that FBI's accrual practices are overly manual due to an outdated system, and that improvements are needed in several other areas, most notably in FBI's management of and control over property and equipment. At the USMS, the auditors reported weaknesses in IT systems general and application controls, and weaknesses in the separation of duties within the finance office. Auditors at the USMS also reported issues with property related accounting. At ATF, weaknesses in determining accurate amounts owed on vendor obligations prevented an unqualified opinion and disclosed that fundamental improvements in ATF's business practices are needed in that area.

Corrective Action Efforts

Our corrective action efforts for FY 2005 started last summer when the severity of the difficulties at OJP surfaced. While corrective action at OJP is clearly the key to the restoration of the Department's unqualified opinion, I want

to assure the Committee that we are making concerted efforts to address the material weaknesses and other conditions reported by the auditors at every component. Each component is responsible for preparing and following individual corrective action plans that I oversee as Chief Financial Officer. These are detailed plans containing timelines for deliverables and metrics for measuring progress towards completion. For example, within the Justice Management Division (JMD), I have a Finance Staff team dedicated to quality assurance reviews within the OBD's and the WCF. This group, which focuses on both training and accountability, has been successfully deployed for several years. The team has made over 30 trips to headquarters and field offices already this year to review financial transactions for completeness and accuracy. BOP and DEA employ similar quality reviews to prepare for the audits. The FBI's Finance Division is working hard to carry out planned improvements in its accounting and property areas, giving particular attention to ensuring an effective and efficient communication process is established with the auditors this year so that any audit issues are promptly surfaced and resolved. ATF and the USMS are also actively pursuing their corrective action plans.

Our efforts at OJP are extensive and ongoing. Last summer we formed two dedicated JMD teams to work with OJP management to address the problems identified in the 2004 audit. One group is working to address the grant accounting weaknesses and one group is working to address the IT systems weaknesses. On the accounting side, we have assigned a senior JMD finance

professional to be the full time 2005 audit manager at OJP. Joint teams of OJP and JMD financial managers, with contract accounting support, have performed extensive accounting reviews and data reconciliations in order to demonstrate the reliability of OJP journal vouchers and other system entries. The teams have three separate efforts ongoing to produce reliable and auditable grant accruals for 2003, 2004, and the 2005 financial statements, key work that must be done successfully for the Department to again earn an unqualified clean opinion. On the IT systems side, OJP has hired a new Chief Information Officer (CIO), and the new CIO, working with one of my deputies who is also the Department's CIO, has developed and implemented a wide array of new security controls, strengthened separation of duties, eliminated application and data access weaknesses, and installed formal change control procedures across the OJP applications. While our corrective action efforts are still in process and it is too early in the 2005 audit to see any confirmed audit results yet, I am committed to ensuring that the new generation of systems and accounting controls that we have been installing will provide OJP with the necessary tools to produce reliable and auditable financial statements.

In addition to the corrective actions at our components that I've mentioned, we have implemented two innovations from a Department-wide CFO perspective that I believe are important. First, one of the hard lessons learned from last year was that we did not have adequate "early warning" of audit problems, especially the severity of the problems, within our component audits.

As a result, we could not, from a CFO standpoint, intervene and implement corrective actions in time when severe problems arose. This year we have instituted several formal “checkpoints” throughout the audit process where I meet personally with the Inspector General and the auditors on the status of the ongoing audits. While I am cognizant of the fact that even these reviews cannot disclose every potential problem early, since by necessity the detailed testing results are often not known until late in the audit process, I believe these sessions will aid us greatly in our oversight of the audits.

A second innovation this year is a dedicated CFO internal evaluation and review group. When I became the Department’s CFO in late November of 2002, I was surprised to learn that, despite the CFO’s responsibility to manage and report on the financial activities of an agency with an annual budget of over \$22 billion (including reimbursable authority), the CFO had no organization designed to perform Department-wide reviews of internal controls and financial reporting. It is virtually unheard of in private industry to have a \$22 billion dollar corporation without an internal auditing or review function reporting to the CFO. As a result, we have formed a dedicated internal review and evaluation group within the CFO function that will help assist us in evaluating the adequacy and integrity of our financial operations and internal controls on an ongoing basis. The dedicated group will also assist us in meeting the new federal internal control guidelines set by OMB in Circular A-123, *Management’s Responsibility for Internal Control*. These guidelines, modeled after the Sarbanes-Oxley legislation

enacted by Congress, become effective in FY 2006, but we have moved to get an early start. In the long term, we expect this function to help improve the overall quality of data and the efficiency of operations. We also expect it to provide timely alerts to management of significant accounting issues that could adversely affect the audit and enable correction action before such issues negatively impact the audit.

Financial Systems at Justice

The final area I would like to discuss is the precarious state of the Department's financial systems. On a personal note, Mr. Chairman, I particularly appreciate your request that my testimony address ways you could be helpful and supportive for our efforts to provide high quality financial management as well as accurate and timely financial reporting. Our Department's financial systems are at the core of our ability to protect and manage our financial resources. Our ability to ensure reliable management of our financial resources depends primarily on replacing the myriad of financial systems in DOJ with one modern integrated accounting system which supports the Department's needs. I believe most people would be surprised to learn that the Department uses seven different core accounting systems to manage its budget and financial operations. These seven systems perform our core accounting and enable our public financial reporting. We also manage dozens of subsidiary systems, often called "feeder" systems, but that is a fairly typical situation across government and many corporations. What is not typical, or desirable, is having key management and financial data spread

out across seven core accounting systems using dissimilar conventions and which do not provide compatibility for Department-wide financial status reporting. Beyond that fundamental limitation, the FBI's system is seriously outdated and requires replacement immediately. The independent auditors have noted that the FBI's legacy financial system is over 25 years old and was not designed for today's accounting standards. Since 9/11, the FBI budget has increased by 80% or almost \$2.6 billion. We have transformed the FBI to meet its critical counter-terrorism mission, yet we support the financial backbone of this agency with an outdated financial management system that was installed before personal computers became popular household items. Systems at DEA and ATF are newer but they are commercial systems that must be upgraded to the vendor's latest software version to stay current. OJP's systems have extensive weaknesses in controls, security, and accounting functionality, all of which we are attempting to address short term through the corrective action plans I've mentioned.

We devote extensive – and expensive – resources to collecting financial data from these separate and dissimilar systems in order to do Department-wide financial reporting. On a daily basis, the CFO at Justice has no real time access to Department-wide financial data or performance information. We have no Department-wide diagnostic reports which would have given us early warning of the type of problems that occurred at OJP last year. Instead, dependent on seven systems, we use manual collection procedures and after the fact month-end

reporting as a substitute. It is an inefficient and unsatisfactory way to manage a \$22 billion dollar organization in today's fiscal environment.

We are now seeking resources to implement a Unified Financial Management System, a single core system that will give us coordinated Department-wide financial management capabilities and lower maintenance and operational costs once implemented. We awarded a software contract to a commercial vendor last year, we have completed the testing of the baseline software, and we are now at the stage where our foundation planning for the new system is near completion. However, we do not currently have sufficient funds for the integration work required to configure and implement the system at our components.

While our components have gotten extensive mileage from their current systems, we are at the stage where several of the systems require replacement in the short term. We are at a critical juncture at Justice – we have at least three systems that require immediate replacement or upgrade, with two other systems close behind. It is essential that we obtain sufficient funding for the Unified System and achieve a uniform Department-wide reporting base, or our components will be left to individually replace their systems in the disjointed, uncoordinated manner of the past. We believe, and equally important, based on Inspector General reports, the auditors have also opined that Justice will continue to have financial management problems and have difficulty meeting new federal

security and reporting standards unless we are able to replace our outdated and weak systems. We are requesting funding for the new Unified System rollout in the President's FY 2006 budget, and we urge Congress to support that request.

In closing, I would like to assure the Committee that improved financial management and the production of accurate, auditable public financial statements is one of the Attorney General's, and one of my, highest priorities. We will continue to work closely and effectively with the Inspector General's office to ensure our financial operations are sound and reliable, aggressively re-engineering those that are not. I can assure you that improving our financial management has the personal and direct involvement of our component heads. The Department has proven in the past it can produce reliable financial statements, and we are determined to regain that status this year.

Mr. Chairman, that concludes my prepared statement. I will be happy to answer any questions you or the other subcommittee members may have.